

Report
of the
Examination of
Fall Creek Mutual Insurance Company
Fall Creek, Wisconsin
As of December 31, 2000

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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May 25, 2001

Honorable Connie L. O'Connell
Commissioner of Insurance
State of Wisconsin
121 East Wilson Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of
December 31, 2000, of the affairs and financial condition of

FALL CREEK MUTUAL INSURANCE COMPANY
FALL CREEK, WISCONSIN

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The last examination of this company was made in 1996 as of December 31, 1995.
The current examination covered the intervening time period ending December 31, 2000, and
included a review of such subsequent transactions deemed essential to complete this
examination.

The Summary of Examination Results contains elaboration on all areas of the
company's operations. Special attention was given to the action taken by the company to satisfy
the recommendations and comments made in the previous examination report.

The company was originally organized as a town mutual insurance company on
January 18, 1875, under the provisions of the then existing Wisconsin Statutes. The original
name of the company was the Fall Creek Farmers Mutual Fire Insurance Company. Subsequent
amendments to the company's articles and bylaws changed the company's name to that presently
used.

During the period under examination, there were two amendments to the articles of incorporation and one amendment to the bylaws. The most current amended bylaw (effective March 20, 2001) clarifies the Office Assistant's and Manager's responsibilities to the company. The amended article approved by the membership on March 22, 1988, which was filed with this office on October 8, 1997, indemnifies each director, officer, employee or person serving on a Company committee by the Company for lawsuits brought against them due to their work with the Company. An amended article effective March 18, 1997 changed the Annual Meeting date to the third Tuesday in March of each year at 1:30 P.M.

A review of the certificate of authority revealed that the company is currently licensed to write business in the following counties:

Eau Claire, Chippewa, Dunn, Jackson, Trempeleau, Buffalo, Clark and Barron.

The company is currently licensed to write property, including windstorm and hail, and nonproperty insurance.

A review was made of the policy and application forms currently used by the company. The company issues an approved policy with or without endorsements for terms of one year, that continuously renews, with premiums payable on the advance premium basis. Policy fees charged policyholders are retained by the company.

Business of the company is acquired through 9 agents, 7 of whom are directors of the company. Agents are presently compensated by receiving a 15% commission on all business written by the agent.

Agents have authority to adjust losses up to \$5,000. Losses in excess of this amount are adjusted by two or more members of the Adjusting Committee. Adjusters receive \$8.00 per hour for each loss adjusted plus \$0.30 per mile for travel allowance.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

Board of Directors

The board of directors consists of nine members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
*Myron Wathke	Retired	Fall Creek, WI	2003
Richard Anderson	Farmer	Chippewa Falls, WI	2003
*Peter Schumacher	Farmer	Elk Mound, WI	2003
*Harold Graff	Farmer	Eau Claire, WI	2002
Joyce Nielsen	Retired	Fall Creek, WI	2002
*Dennis Schacht	Farmer	Augusta, WI	2002
*Everett Reetz	Retired	Augusta, WI	2001
*Dale Noel	Farmer	Fall Creek, WI	2001
*Haakon Olson	Farmer	Eleva, WI	2001

* Directors who are also agents are identified with an asterisk.

Members of the board currently receive \$60 a day and \$40 a half-day for the amount of time spent attending various meetings and \$0.30 per mile for travel expenses.

Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified.

Officers serving at the present time are as follows:

Name	Office	2000 Salary
Haakon Olson	President	\$ 1,400
Harold Graff	Vice-President	None
Joyce Nielsen	Secretary/Manager	\$18,956
Myron Wathke	Treasurer	\$ 1,400

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. A review of the minutes and various other company documents showed that the company formed the following committees approved by the board of directors:

Adjusting Committee: Consists of the entire board of directors;

Inspection Committee: Consists of the entire board of directors;

Audit Committee: Consists of Harold Graff and Everett Reetz;

Forms and Rates Committee: Consists of Dale Noel, Harold Graff and Dennis Schacht;

Personnel Committee: Consists of Richard Anderson and Peter Schumacher.

Growth of Company

The growth of the company during the past five years as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Net Losses and LAE Incurred	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
1996	\$372,606	\$322,558	1,246	(\$54,899)	\$1,913,997	\$1,575,704
1997	372,323	236,066	1,260	39,719	1,997,555	1,606,516
1998	351,644	346,251	1,290	(89,674)	1,999,478	1,576,217
1999	418,198	325,492	1,310	(19,952)	1,972,575	1,537,568
2000	415,781	310,500	1,323	(26,481)	2,052,361	1,553,576

The ratios of premiums written, gross and net, to surplus as regards policyholders during the past five years were as follows:

Year	Gross Premiums Written	Net Premiums Written	Ending Surplus	Writings Ratios Gross	Net
1996	\$742,010	\$487,228	\$1,575,704	47%	31%
1997	645,990	385,198	1,606,516	40	24
1998	644,152	363,893	1,576,217	41	23
1999	739,699	422,879	1,537,568	48	28
2000	750,578	419,162	1,553,576	48	27

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Earned Premiums	Loss Ratio	Expense Ratio	Composite Ratio
1996	\$322,558	\$186,086	\$372,606	87%	38%	125%
1997	236,066	166,266	372,323	64	43	107
1998	346,251	163,948	351,644	99	45	144
1999	325,492	189,873	418,198	78	45	123
2000	310,500	191,645	415,781	74	46	120

Gross and Net Premiums Written by the company increased slightly and policies in force has increased 6% over the period under examination. The company reported net losses four out of the last five years, underwriting losses six out of the past seven years and gains in its investments of \$122,729. Even with the investment gains, the company experienced a decrease in surplus of \$22,128. It was also noted that the company had high loss and expense ratios for three consecutive years beginning in 1998 due to the frequency of reported losses.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed that there is currently one ceding treaty. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2001, continuous
Termination provisions:	By either party, on any January 1, with 90 days' advanced written notice.

The coverage provided under this treaty are summarized as follows:

- | | |
|----------------------|-----------------------------------------------------------------------------------------------------------|
| Type of contract: | <i>Class A Excess of Loss Reinsurance</i> |
| Lines reinsured: | <i>All nonproperty business written by the company (casualty business).</i> |
| Company's retention: | <i>\$750 each occurrence</i> |
| Coverage: | <i>100% above the \$750 retention</i> |
| Policy limits: | \$1,000,000 per occurrence, with a medical payment limit of \$5,000 per person and \$25,000 per accident. |
| Reinsurance premium: | 75% of the gross liability premiums |
- | | |
|----------------------|----------------------------------------------|
| Type of contract: | Class B First Surplus Reinsurance |
| Lines reinsured: | All property business written by the company |
| Company's retention: | \$250,000 for each occurrence |
| Coverage: | Up to \$800,000 per risk |
| Reinsurance premium: | Pro rata portion of the subject premium |
| Ceding commission: | 15% provisional, varies with loss ratio |
- | | |
|------------------------------|----------------------------------------------------|
| Type of contract: | Class C Excess of Loss Reinsurance |
| Lines reinsured: | All property business written by the company |
| Company's retention: | \$30,000 for each occurrence |
| Annual Aggregate Deductible: | \$30,000 each contract year |
| Coverage: | \$70,000 in excess of \$30,000 for each occurrence |

	Reinsurance premium:	9.04% of the current net written premiums and an annual deposit premium of \$42,900
4.	Type of contract:	Class C Second Excess of Loss Reinsurance
	Lines reinsured:	All property business written by the company
	Company's retention:	\$100,000 for each occurrence
	Coverage:	100% up to \$150,000
	Reinsurance premium:	4% of the current net written premiums and an annual deposit premium of \$18,900
5.	Type of contract:	Class D/E Stop Loss Reinsurance
	Lines reinsured:	All property business written by the company
	Company's retention:	Combined aggregate losses up to 75% of net premiums written (minimum retention of \$305,000)
	Coverage:	100% of the amount exceeding the company's retention level
	Reinsurance premium:	5% of the current net written premiums and an annual deposit premium of \$31,500

III. FINANCIAL DATA

The following financial statements were filed with the Commissioner of Insurance in the company's annual statement at December 31, 2000. Adjustments made, as a result of the examination, are noted at the end of this section of this report in the area captioned "Reconciliation of Policyholders' Surplus."

Fall Creek Mutual Insurance Company
Statement of Assets and Liabilities
As of December 31, 2000

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash in Company's Office	\$ 100	\$	\$	\$ 100
Cash Deposited in Checking Account	44,881			44,881
Cash Deposited at Interest	630,777			630,777
Bonds (at Amortized Cost)	611,350			611,350
Stocks or Mutual Fund Investments (at Market)	531,086			531,086
Real Estate (Net of Accumulated Depreciation and Encumbrances)	16,881			16,881
Premiums and Agents' Balances In Course of Collection	5,698			5,698
Premiums and Agents' Balances and Installments Booked But Deferred and Not Yet Due	171,115			171,115
Investment Income Due or Accrued		14,044		14,044
Reinsurance Recoverable on Paid Losses and LAE	625			625
Electronic Data Processing Equipment - Excluding Software (Cost Less Accumulated Depreciation)	753			753
Other Assets (Show in Detail)				
Reinsurance Contingent Commissions Receivable	<u>25,051</u>	<u> </u>	<u> </u>	<u>25,051</u>
TOTALS	<u>\$2,038,317</u>	<u>\$14,044</u>	<u>0</u>	<u>\$2,052,361</u>

Liabilities and Surplus

Net Unpaid Losses	\$ 48,098
Unpaid Loss Adjustment Expenses	2,000
Commissions Payable	34,091
Fire Department Dues Payable	71
Federal Income Taxes Payable	3,390
Net Unearned Premiums	293,268
Reinsurance Payable	80,577
Other Liabilities:	
Expense Related	
Accounts Payable	148
Accrued Salaries and Wages	25,735
Nonexpense Related:	
Premiums Received in Advance	11,408
	<hr/>
TOTAL LIABILITIES	498,786
Policyholders' Surplus	<u>1,553,575</u>
TOTAL	<u>\$2,052,361</u>

Fall Creek Mutual Insurance Company
Statement of Operations
For the Year 2000

Net Premiums and Assessments Earned	<u>\$415,781</u>
Deduct:	
Net Losses Incurred	287,299
Net Loss Adjustment Expenses Incurred	23,201
Other Underwriting Expenses Incurred	<u>191,645</u>
Total Losses and Expenses Incurred	<u>502,145</u>
Net Underwriting Gain (Loss)	<u>(86,364)</u>
Net Investment Income:	
Net Investment Income Earned	71,102
Net Realized Capital Gains	<u>2,667</u>
Total Investment Income	<u>73,769</u>
Other Income:	
Miscellaneous Income	<u>175</u>
Net Investment and Other Income	<u>73,944</u>
Net Income (Loss) Before Policyholder Dividends and Before Federal Income Taxes	(12,420)
Policyholder Refunds or Dividends	<u>0</u>
Net Income (Loss) Before Federal Income Taxes	(12,240)
Federal Income Taxes Incurred	<u>14,062</u>
Net Income (Loss)	<u>(\$26,482)</u>

Fall Creek Mutual Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Five-Year Period Ending December 31, 2000

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

Surplus as regards policyholders, December 31, 1995		\$1,588,389
1996		
Net income (loss)	(\$54,899)	
Net unrealized capital gains or losses	42,883	
Change in nonadmitted assets	<u>(669)</u>	
Change in surplus as regards policyholders for the year		<u>(12,685)</u>
Surplus as regards policyholders, December 31, 1996		1,575,704
1997		
Net income (loss)	39,719	
Net unrealized capital gains or losses	(9,564)	
Change in nonadmitted assets	<u>657</u>	
Change in surplus as regards policyholders for the year		<u>30,812</u>
Surplus as regards policyholders, December 31, 1997		1,606,516
1998		
Net income (loss)	(89,674)	
Net unrealized capital gains or losses	58,001	
Change in nonadmitted assets	<u>1,374</u>	
Change in surplus as regards policyholders for the year		<u>(30,299)</u>
Surplus as regards policyholders, December 31, 1998		1,576,217
1999		
Net income (loss)	(19,952)	
Net unrealized capital gains or losses	(18,226)	
Change in nonadmitted assets	<u>(471)</u>	
Change in surplus as regards policyholders for the year		<u>(38,649)</u>
Surplus as regards policyholders, December 31, 1999		1,537,568
2000		
Net income	(\$26,482)	

Net unrealized capital gains or losses	42,874	
Change in nonadmitted assets	<u>(385)</u>	
Change in surplus as regards policyholders for the year		<u>16,007</u>
Surplus as regards policyholders, December 31, 2000		
		<u>\$1,553,575</u>

Reconciliation of Policyholders' Surplus

There were no adjustments made to Surplus per examination of the company as of December 31, 2000. The Policyholders' surplus balance at year-end 2000 remains at \$1,553,575.

Reclassification Account	Debit	Credit
Agents' Balances and Installments Booked but Deferred and Not Yet Due		\$6,366
Advance Premiums	<u>6,366</u>	<u> </u>
Total	<u>\$ </u>	<u>\$ </u>

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Corporate Records—It is recommended that the company have the secretary sign the minutes of all meetings held by the board of directors.

Action—The Company has complied.

2. Corporate Records—It is recommended that the Company adequately documents in the board of director meetings the discussion of all investments made by the company and that approval be obtained before the purchase, sale, or renewal of all investments of the company.

Action—The Company has complied.

3. Corporate Records—It is recommended that the Company state in the minutes of meetings held whether a motion has been approved by stating “motion carried” or wording to indicate that the motion was approved by the majority in attendance.

Action—The Company has complied.

4. Corporate Records—It is again recommended that the Company, in accordance with s. 612.13(4), Wis. Stat., create an adjusting committee approved by the board of directors.

Action—The Company has complied.

5. Articles of Incorporation—It is again recommended that the Company complies with s. 612.04, Wis. Stat., and any changes in the articles be approved and filed with this Office.

Action—The Company has complied.

6. Articles of Incorporation—It is recommended that the Company comply with s. 612.12(1)(b), Wis. Stat., as regards to voting rights of policyholders.

Action—The Company has complied.

7. Underwriting—It is again suggested that the company establish a formal inspection procedure for new and renewal business, whereby a sampling of new applications and of renewal business is inspected by committee members independent of the risk under consideration.

Action—The Company has partially complied, this is discussed further in upcoming pages.

8. Accounts and Records—It is suggested that the Company increase the limit for the dual signature requirement.

Action—The Company has complied.

9. Accounts and Records—It is recommended that the Company not use a signature stamp for signing checks.

Action—The Company has complied.

10. Accounts and Records—It is recommended that the schedules for investments in the Annual Statement be completed properly in accordance with the Annual Statement Instructions on all future Annual Statements.

Action—The Company has complied.

11. Invested Assets—It is again recommended that the Company comply with s. Ins 13.05, Wis. Adm. Code, as regards to control of its invested assets.

Action—The Company has complied.

12. Invested Assets—It is also recommended that the Company comply with s. 610.23, Wis. Stat., and either hold securities under an approved safekeeping agreement with a bank or banking and trust company or hold securities in a safety deposit box in accordance with s. Ins. 13.05(4), Wis. Adm. Code.

Action—The Company has complied.

13. Cash and Invested Assets—It is recommended that the Company, in accordance with the town mutual Annual Statement instructions, record any cash received at or near year-end but not deposited be reported on the Annual Statement as cash in the Company's office.

Action—The Company has complied.

14. Cash and Invested Assets—It is again recommended that the Company establishes a liability for escheatable funds, and that the Company file reports in accordance with ch. 177, Wis. Stat.

Action—The Company has complied.

15. Uncollected Premiums—It is recommended that the Company record premiums based on the effective date of the policy, not the date processed.

Action—The Company has complied.

16. Net Unpaid Losses—It is recommended that the Company include sufficient data in its claim files to support claims closed without payment, in accordance with s. Ins 13.05(4)(e), Wis. Adm. Code.

Action—The Company has complied.

17. Unpaid Loss Adjustment Expense—It is again recommended that loss adjusting records by loss be maintained.

Action—The Company has complied.

Current Examination Results

Management and Control

The company has been successful in keeping its directors on the board for many years. It appears that some directors may be retiring from the board in the near future. The company will need to recruit new directors. The company could create additional director positions by amending its current articles and bylaws, to allow new directors to learn from the experienced directors.; it may take a new director several years of experience on the board to learn all the responsibilities and technical insurance knowledge required to be a good director. It is suggested that the board of directors develop a plan for recruiting new directors, and consider expanding the number of director positions to allow new directors to be mentored by the experienced directors.

It was noted that seven of the directors are agents who in total write a large portion of the Company's business. The agreements with agents do not address what happens to the agent's block of business in the event of the death, disability or retirement of the agent. It is suggested that the Company amend its agent agreements to address the agents' block of business in the event of the death, disability or retirement of the agent.

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and any committees thereof, were reviewed for the period under examination and also for the subsequent current period.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed formal written agreements with its agents. The contracts include language indicating the agent will represent the company's interests "in good faith."

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to

conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with no apparent conflicts being noted.

Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

Type of Coverage	Coverage Limits
Fidelity Bond Coverage	Single loss limit is \$250,000
Property Coverage	Commercial Building: \$70,000 Commercial Contents: \$30,000
General Commercial Liability Coverage	
Products-Completed Operations Aggregate Limit:	\$1,000,000
General Aggregate Limit:	\$1,000,000
Personal & Advertising Injury Limit:	\$1,000,000
Damage to Premises Rented to you Limit:	\$100,000 per premise
Medical Expense Limit:	\$5,000 per person
Workers Compensation	Meets statutory requirements
Errors & Omissions Coverage for agents of Fall Creek	
	Limit for each claim is \$1,000,000 Aggregate Limit is \$1,000,000
Professional Liability	Limit per claim is \$3,000,000 Aggregate limit is \$3,000,000
Directors and Officers Liability	Limit per claim is \$3,000,000 Aggregate limit is \$3,000,000

Underwriting and Claims Handling

The company does not have a documented procedure for handling claims, to assure that claimants are treated fairly and equitably that is consistent with s. Ins 6.11, Wis. Adm. Code, including that depreciation is fairly and consistently applied to losses for actual cash value policies, and the value of policyholder labor in making repairs to property is fairly compensated. It is recommended that the company adopt: a depreciation guideline that covers methods of

depreciation for classes of insured assets such as building components and personal property; procedures to assure that the type of coverage (replacement cost or actual cash value) is identified on each claim; procedures to assure that actual cash value claims are handled consistently with regard to depreciation; and procedures to ensure that the value of policyholder labor in making repairs is fairly compensated.

The company does not have a process to assure that inspections of renewal business are performed consistently and in sufficient time before renewal dates so that a change in coverage or nonrenewal could be issued on a timely basis consistent with s. 631.36, Wis. Stat. It is recommended that the company adopt: a checklist or guide for the inspection of each class of business the company writes (homeowners, farmowners, mobile home, etc.); a timeline (relative to renewal date) for the company to notify agents of renewal inspections to be performed, a deadline for the agent to perform each inspection, a procedure for the company to obtain an inspection if the agent does not meet the deadline to perform the inspection; and a procedure to ensure that information from the inspection report is evaluated before the statutory deadlines for notices of nonrenewal or changes in coverage to the policyholder.

The company does not have a consistent method for determining the value of buildings it insures; each agent makes his or her own estimate of value using various methods. It is recommended that the company: research and select a building valuation manual, train agents in the use of the manual, and develop and implement reporting forms to be used with inspections of new and renewal business to document how each building has been valued using the techniques in the building valuation manual.

The company does not have a process to regularly review the adequacy of its rates on each line of business, and to compare its rates with its competitors. It is suggested that the company develop a process to periodically review its rate adequacy on each line of business, and to compare its rates with its competitors.

Claims Adjusting

The company does have an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust or supervise the adjustment of losses.

Accounts and Records

The examiners' review of the company's records indicated that the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained
2. A proper cash receipts journal is maintained
3. A proper cash disbursements journal is maintained
4. A proper general journal is maintained
5. A proper general ledger is maintained

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2000.

The company is audited annually by an outside public accounting firm.

EDP Environment

Company personnel were interviewed with respect to the company's Electronic Data Processing environment. Access to the computers are limited to people authorized to use the computers.

Company personnel back up the computers daily and the backed-up data is kept offsite.

A manual which describes how to use the company's software and outlines the steps to complete specific tasks assists in the continuity of operations for seldom-used applications, training, or when staff turnover occurs. The company has manuals documenting the use of its software.

Disaster Recovery Plan

A disaster recovery plan identifies steps to be performed in case the company loses a key employee, is not able to access its computer, information on its computer was lost, or the office building was destroyed, to name a few contingencies. The company has not developed a disaster recovery plan. It is recommended that the company develop a comprehensive disaster recovery plan that would clearly identify what would be done in cases where it is not able to access its computers, the office building is destroyed or if a key employee is lost.

Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

- (1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and
- (2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company is in compliance with these requirements.

Transition into the New Investment Rule

On January 1, 1996, the investment rule for town mutuals was amended to allow town mutuals to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as "Type 2") provided that the town mutual has a sufficient amount of lower risk investments (referred to as "Type 1"). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1. Liabilities plus \$300,000	\$ 798,786
2. Liabilities plus 33% of gross premiums written	746,477
3. Liabilities plus 50% of net premiums written	708,367
4. Amount required (greater of 1, 2, or 3)	798,786
5. Amount of Type 1 investments as of 12/31/2000	<u>1,167,765</u>
6. Excess or (deficiency)	<u>\$ 368,979</u>

The company does have sufficient Type 1 investments.

The new investment rule prescribes that a town mutual shall divest any investment which does not comply with the rule within three years of its noncompliance, unless the Commissioner permits a longer period or requires a shorter period. Currently the company has no investments which are not in compliance with the new investment rule.

ASSETS

Cash and Invested Cash	\$675,758
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The above asset is comprised of the following types of cash items:

Cash in company's office	\$ 100
Cash deposited in banks-checking accounts	44,881
Cash deposited in banks at interest	<u>630,777</u>
 Total	 <u>\$675,758</u>

Cash in the company's office at year-end represents the company's petty cash fund.

The examiners during the course of the examination made a physical count and the balance reconciled to year-end.

Cash deposited in banks subject to the company's check and withdrawal consists of one account maintained in one bank. Verification of checking account balances was made by obtaining confirmations directly from the depository and reconciling the amounts shown thereon to company records.

Cash deposited in banks represents the aggregate of twenty deposits in eleven depositories. Deposits were verified by direct correspondence with the respective depositories and by an actual count and inspection of certificates and/or passbooks. Interest received during the year 2000 totaled \$39,896 and was verified to company cash records. Rates of interest

earned on cash deposits ranged from 3% to 6.99%. Accrued interest on cash deposits totaled \$2,167 at year-end.

Book Value of Bonds

\$611,350

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2000. Bonds owned by the company are located in a safety deposit box at a local bank or are held in a banking and trust company with a proper custodial agreement.

Bonds in the safety deposit box were physically inspected by the examiners. Bond purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in bonds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Interest received during 2000 on bonds amounted to \$37,650 and was traced to cash receipts records. Accrued interest of \$8,381 at December 31, 2000, was checked and allowed as a nonledger asset. Interest rates on bonds held ranged from 4.75% to 8.0%

Stocks and Mutual Fund Investments

\$531,086

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2000. Stocks owned by the company are located in a safety deposit box at a local bank or are held in a banking and trust company with a proper custodial agreement.

Stock certificates in the safety deposit box were physically examined by the examiners. Stock and mutual fund purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Dividends received during 2000 on stocks and mutual funds amounted to \$16,674 and were traced to cash receipts records. Accrued dividends of \$3,496 at December 31, 2000, were checked and allowed as a nonledger asset.

Book Value of Real Estate**\$16,881**

The above amount represents the company's investment in real estate as of December 31, 2000. The company's real estate holdings consisted of home office building.

The required documents supporting the validity of this investment were reviewed and were in order. Adequate hazard insurance was carried on the real estate and contents as noted under the caption, "Fidelity Bond and Other Insurance." The company's investment in real estate and related items was in conformance with the Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. Real estate depreciation is calculated using the straight-line method; accelerated methods are used for additions made to real estate.

Agents' Balances or Uncollected Premiums**\$176,813**

The above ledger asset represents the amounts due from agents or policyholders which are not in excess of 90 days past due at year-end. A review of individual agent's accounts verified the accuracy of this asset. At year-end 2000, \$6,366 of policyholder payments in advance of the due date for deferred installments (for example, a quarterly payment due in January 2001 but received in December 2000) had been received. The company reported this \$6,366 as part of the liability for Advance Premiums; the company should have reduced the balance for Uncollected Premiums by this amount, but there was no effect on policyholders' surplus. This is discussed further in the Advance Premiums section of this report.

Investment Income Due and Accrued**\$14,044**

Interest due and accrued on the various assets of the company at December 31, 2000, consists of the following:

Cash Deposited at Interest	\$ 2,167.65
Bonds	8,380.93
Stocks & Mutual Funds	<u>3,495.65</u>
Total	\$14,044.23

The amounts were verified by tracing to subsequent cash receipts, 1099 forms and/or brokerage statements.

Reinsurance Recoverable on Paid Losses **\$625**

The above asset represents recoveries due to the company from reinsurance on losses which were paid on or prior to December 31, 2000. A review of year-end accountings with the reinsurer and the calculation of the paid LAE to paid loss ratio verified the above asset.

Equipment, Furniture, and Supplies **\$0**

This asset consists of \$4,348.16 of net book value of equipment and fixtures owned by the company at December 31, 2000. In accordance with annual statement requirements, this amount has been deducted as an asset not admitted.

Electronic Data Processing Equipment **\$753**

This asset represents the depreciated value of electronic data processing equipment purchased in 1996 through 2000. The company properly expensed software. The most recent purchases were traced to invoices and the company's cash disbursement records.

Reinsurance Contingent Commissions Receivable **\$25,051**

This asset represents amounts due from the reinsurer for sliding scale commissions under the Class B – First Surplus contract. The amount was traced to subsequent cash receipts and to documentation from the reinsurer.

LIABILITIES AND SURPLUS

Net Unpaid Losses

\$48,098

This liability represents losses incurred on or prior to December 31, 2000, and remaining unpaid as of that date. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule.

	Company Estimate	Examiners' Development	Difference
Incurred But Unpaid Losses	\$141,713	\$175,089	\$33,376
Less:			
Reinsurance Recoverable on Unpaid Losses	<u>93,615</u>	<u>129,001</u>	<u>35,385</u>
Net Unpaid Losses	<u>\$ 48,098</u>	<u>\$ 46,088</u>	<u>\$ 2,010</u>

The examiners developed this liability by totaling actual loss payments made through the development period on those losses incurred on or prior to December 31, 2000. To the actual paid loss figures was added an estimated amount for those 2000 and prior losses remaining unpaid at the examination date, if any. Although the results of the development show that the Company's reserves appear to be redundant, an adjustment to increase surplus to reflect this apparent redundancy is not being made. A review of the claims made showed some, which had large reserves established, to have been closed without payment or their reserves were significantly reduced in amount. It is possible these claims could be reopened or reduced reserve amounts could be increased. The amount of the increase represents less than 0.2% of surplus. The apparently redundant reserves show that the Company was conservative in establishing the reported reserve amounts.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and all claims which were denied during the examination period. The review indicated that claims are investigated and evaluated properly and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained.
2. Claim files contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed.

There was one problem noted concerning unfair claims handling. The recommendation was made in the “underwriting and claims handling” section of the report.

Unpaid Loss Adjustment Expenses **\$2,000**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2000, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is based on the history of the amounts of claims incurred at year-end but not reported and the related adjusting expenses.

The examiners' analysis of expenses incurred in the current year related to the settlement of prior year losses, as well as estimates of amounts necessary to settle any prior losses remaining unpaid at the examination date, determined this liability to be adequately stated.

Unearned Premiums **\$293,268**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology. The examiners' tests of the unearned premium balance proved that the balance was adequately and fairly presented on the Annual Statement, except for an error regarding the treatment of Advance Premiums which is discussed later in this report.

Reinsurance Payable **\$80,577**

This liability consists of amounts due to the company's reinsurer at December 31, 2000, relating to transactions that occurred on or prior to that date. The Annual Statement amount consisted of a deferred reinsurance balance (of \$39,624) that was traced to a year-end deferred premium report supplied by the reinsurer. The rest of the balance was verified through subsequent cash disbursements and reinsurance accountings.

Federal Income Taxes Payable **\$3,390**

This liability represents the balance payable at year-end for federal income taxes incurred prior to December 31, 2000.

The examiners reviewed the company's 2000 tax return and verified amounts paid to cash disbursement records to verify the accuracy of this liability.

Fire Department Dues Payable **\$ 71**

This liability represents the fire department dues payable at December 31, 2000.

The examiners reviewed the company's fire department dues calculation and found this liability to be correctly calculated. The actual amount paid was verified to the cash disbursement records.

Accrued Salaries and Wages **\$25,735**

This Liability consists of the following accruals:

2000 Payroll	\$ 1,998.64
Vacation	10,127.92
Sick Leave	<u>13,608.00</u>
Total	\$25,734.56

The vacation and sick leave days were based on information provided by the Company. Payroll records were also used to calculate this liability.

Accounts Payable **\$ 148**

This liability represents amounts for expenses incurred in 2000 but not paid as of year-end. Supporting records and cash disbursements verified this item.

Commissions Payable **\$34,091**

This liability represents the commissions payable at December 31, 2000. Amounts from the commissions payable register were traced to cash disbursement detail.

Premiums Received in Advance **\$11,408**

The company reported a balance of \$11,408 for advance premium as of December 31, 2000. This included all premium payments received on or before that date that were due subsequent to year-end. This included payments in the two following groups:

1. Payments made in advance on a subsequent policy year -- \$5042.
2. Payments made in advance of an installment becoming due subsequent to year-end, made during the current policy year -- \$6366.

An example of a payment included in group #1 above is a payment made before year-end on a policy with the anniversary date of January 5, 2001. This is a payment that should properly be included on Liability line 12f: Premiums Received In Advance. A group #2 example is a policy, paid on a quarterly basis, having an anniversary date of October 15, 2000, with the quarterly installment due January 15, 2001 being paid before year-end. This payment should not be

included on Liability line 12f. The correct reporting for group #2 items is to reduce the asset Premiums, Agents' Balances and Installments Booked but Deferred and Not Yet Due. It is recommended that the company only include payments made in advance of a subsequent policy year in the line item Premiums Received in Advance per the Town Mutual Annual Statement Instructions.

The company reduced its liability for unearned premiums by the amount of advance premiums reported (group #1 and group #2). Examiners determined that the computer-generated reports used by the company to compute unearned premium reserve must be adjusted for advance payments on deferred installments (group #2 items). However, the company also reduced the unearned premium report for advance payments on future policy years (group #1 items), which is not correct. Therefore, the unearned premium reserve was understated by the amount of group #1 items, or \$5,042, and policyholders' surplus was overstated by that amount. An adjustment to surplus concerning item #1 was not considered necessary. It is recommended that the company exclude any improper reconciling items from its reconciliation of unearned premium reserve.

V. CONCLUSION

The examination of Fall Creek Mutual Insurance Company resulted in 6 recommendations, 3 suggestions, no adjustments to surplus and 1 reclassification. A majority of the recommendations dealt with underwriting improvements. With an improved underwriting process the Company should be able to produce profits.

The company's surplus of \$1,553,576 decreased 1.4% over the past five years. The company reported 2000 gross premiums written of \$750,578 a 1.5% increase from the prior year. The company experienced underwriting losses the last five years and six out of the last seven years. The Company's loss ratio for the past three years averaged 73% and its expense ratio averaged 45%. As noted above implementation of recommendations on underwriting practices and procedures should improve profitability.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 17 - Management and Control—It is suggested that the board of directors develop a plan for recruiting new directors, and consider expanding the number of director positions to allow new directors to be mentored by the experienced directors.
2. Page 17 - Management and Control—It is suggested that the Company amend its agency agreements to address the agents' block of business in the event of the death, disability or retirement of the agent.
3. Page 19 - Underwriting and Claims Handling—It is recommended that the company adopt: a depreciation guideline that covers methods of depreciation for classes of insured assets such as building components and personal property; procedures to assure that the type of coverage (replacement cost or actual cash value) is identified on each claim; procedures to assure that actual cash value claims are handled consistently with regard to depreciation; and procedures to ensure that the value of policyholder labor in making repairs is fairly compensated.
4. Page 19 - Underwriting and Claims Handling—It is recommended that the company adopt: a checklist or guide for the inspection of each class of business the company writes (homeowners, farmowners, mobile home, etc.); a timeline (relative to renewal date) for the company to notify agents of renewal inspections to be performed, a deadline for the agent to perform each inspection, a procedure for the company to obtain an inspection if the agent does not meet the deadline to perform the inspection; and a procedure to ensure that information from the inspection report is evaluated before the statutory deadlines for notices of nonrenewal or changes in coverage to the policyholder.
5. Page 20 - Underwriting and Claims Handling—It is recommended that the company: research and select a building valuation manual, train agents in the use of the manual, and develop and implement reporting forms to be used with inspections of new and renewal business to document how each building has been valued using the techniques in the building valuation manual.
6. Page 20 - Underwriting and Claims Handling—It is suggested that the company develop a process to periodically review its rate adequacy on each line of business, and to compare its rates with its competitors.
7. Page 22 - Disaster Recovery Plan—It is recommended that the Company develop a comprehensive disaster recovery plan that would clearly identify what would be done in cases where it is not able to access its computers, the office building is destroyed or if a key employee is lost.
8. Page 30 - Premiums Received in Advance—It is recommended that the company only include payments made in advance of a subsequent policy year in the line item Premiums Received in Advance per the Town Mutual Annual Statement Instructions.
9. Page 31 - Premiums Received in Advance—It is recommended that the company exclude any improper reconciling items from its reconciliation of unearned premium reserve.

VII. ACKNOWLEDGMENT

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, Mark Lasowski of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Respectfully submitted,

John Litweiler
Examiner-in-Charge